

Challenges of Public Internal Financial Control in Georgia

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“The conventional wisdom is that Government cannot be effective in the absence of public trust. Government auditors play a central role in fostering such trust, and have even been referred to as the guardians of public trust. Without them, citizens would lack credible insight into the soundness of the many inner workings of government.”

Richard Chambers IIA President and CEO 2011

Abstract

Partial or full absence of public internal financial control in public institutions put effectiveness, saving, productivity, transparency and accountability of state funds in a significant threat. Effective and targeted expenditure of the budget funds is impossible without a properly working internal financial control and management system. The public institution has an obligation to dispose of the budget funds legally, transparently, economically, efficiently and productively. Public institutions differ from private business; each of its events should be analyzed and selected from the alternatives to ensure quality, timeliness, equality and compliance with demands of the population. For this purpose and for its proper functioning there is a need for each public institution to set up risk management, strategic planning, communication, human resources and other mechanisms that create an efficient public institution. All of this is provided with an effective internal financial control system that includes financial management and control, as well as a set of rules and regulations, control mechanisms, exchange of relevant information, risk management and reporting system. Implementation of an effective internal financial control system ensures the establishment of an optimal and high-quality decision-making system.

Keywords: Internal Audit, Internal Financial Control, Public Sector, Public Finance.

Introduction

The necessity of introduction of an internal financial control system in Georgia is due to the commitment of

the Financing Agreement between the European Commission and the Government of Georgia in 2007 - “Supporting Georgian Financial Management Reform”. In order to fulfill this agreement, the Ministry of Finance of Georgia has developed a strategic document in 2009 on “Public Internal Financial Control Development Strategy” (2009-2013), according to which it was planned to establish and develop internal financial control system in the public sector. In addition, in 2014 the Association Agreement was signed “between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Georgia, of the other part”, where the Chapter 2 of V Volume provides the tasks of managing public finance management and internal control.

It should be noted that the reform of the state internal financial control started in 2010 essentially when the Georgian Parliament adopted the Law on “Public Internal Audit and Inspection”, which is the main basis for the formation of internal financial control system.

Internal financial control and management

The system of internal financial control consists of: internal audit and financial management and control. According to the EU model, the Public Internal Control Department of the Ministry of Finance of Georgia (Central Harmonization Unit) is the body responsible for the development, coordination and harmonization of Financial Management and Control, as well as internal audit system through the Georgian Public Sector.

The coordinating role of the Central Harmonization Unit requires relationship with all interested parties of the system, including all budgetary institutions, Civil Service Bureau, State Audit Office and all parties involved in the reform, which affects its course. PIFC is the part of PFM (Public Financial Management) and PAR (Public Administration Reform).

According to the Institute of Internal Auditors, “internal auditing is an independent, objective assurance and consulting activity designed to add value and im-

prove an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes". In other words, we can state that an internal audit is responsible for monitoring the effectiveness of internal control processes that have been established by management within organizations. The effectiveness of the internal control system contributes in important ways to the implementation of a common system of management and control of public finances (The IIA, 2011).

The internal audit units are every government ministries in Georgia. Why is internal auditing important and relevant for the public sector? The following 6 points are key factors that describe this:

1. Government auditing is a cornerstone of good public sector governance as it provides unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results and also by promoting the appropriate ethics and values within the organization. Internal auditors help government organizations achieve accountability and integrity, improve organizational performance management and instill confidence among citizens and stakeholders.
2. The government auditor's role supports the governance responsibilities of oversight, insight and foresight. Oversight addresses whether government entities are doing what they are supposed to do and serves to detect and deter public corruption. Insight assists decision-makers by providing an independent assessment of government programs, policies, operations and results.
3. Internal audit activity has become an essential

internal assurance mechanism in public financial controls and a tool for monitoring and evaluating managerial activities prior to external evaluation by external auditors.

4. Internal auditors further enhance transparency, fairness, reduce corruption and ensure value for money in public procurement. An internal audit function is an essential part of any public expenditure management system and should ensure that public spending is within budgetary provisions; disbursements comply with specified procedures, provides for the timely reconciliation of accounts and effective systems for managing and accounting for physical and financial assets.
5. They also work with management to improve service delivery and ensure compliance with applicable laws, provide independent and objective assurance to an organization's management that its risks are being mitigated to an acceptable level, and reports where they are not.
6. Internal auditors are an integral part of government financial management and an instrument for improving performance and performance management in the public sector. Internal auditors could also play an instrumental role in performing value-for money (VFM) audits otherwise called "Performance Audits." Performance audits are concerned with the audit of economy, efficiency and effectiveness of government expenditures or spending plans. In practice, performance auditing is focused on assessing whether organizations are doing the right things, in the smartest way.

The best way to illustrate the relationship between internal audit and internal control is to show where they both fit in the three lines of defense model. Here's an im-



Adapted from ECIIA/FERMA Guidance on the 8th EU Company Law Directive, article 41

age of the model from the institute of internal auditors:

Internal Control is part of the first line of defense because it is the responsibility of Operational Management, which itself is accountable to Senior Management. **Internal Audit is part of the third line of defense.** It even assesses the effectiveness of the first (Operational Management functions) and second (Risk and Compliance Management functions) lines of defense. Moreover, unlike Internal Control, Internal Audit may report directly to the Board of Directors and specifically the Audit Committee, in order to maintain a certain independence and objectivity when assessing other functions in the company that operate at the first two lines of defense¹.

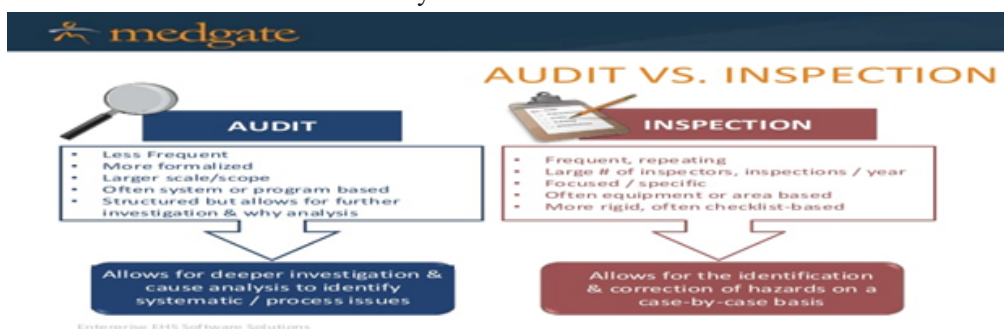
Challenges

Internal financial control reforms have many chal-

lenges in Georgia. During this reform, main challenges for internal auditors are that general provisions of the Law on Public Internal Financial Control on independence of internal auditors do not offer enough safeguards for the independence of IAU-s. Internal auditors are accountable to the head of the institution, which conflicts with Attribute Standard 1100 of the International Standards for the Professional Practice of Internal Auditing.

Also PIFC reform is undermined the poor qualifications, low salaries and the inadequately low number of internal auditors. International Standards on Auditing¹ treat low salaries of auditors as one of the most serious risks to the integrity of the system.

Important challenges are low awareness of internal audit functions in ministries. Most of people thinking that internal audit are not different from inspection. In-



ternal audit needs a different mode of thinking.

Internal auditors do not have a good idea of Major IT risks and controls, and techniques of a technology intensive audit which the Georgian internal audit standards require them to.

Internal audit units do not do periodic self-assessment, which conflicts with Attribute Standard 1311 of the International Standards for the Professional Practice of Internal Auditing. Periodic assessments are conducted to evaluate conformance with the Code of Ethics and the Standards.²

Recommendations: Main recommendations, to solve these problems, are:

In order to ensure the genuine independence of in-

ternal audit units, it is necessary that:

- Periodically conducting, supporting and coordinating trainings for the employees of the internal audit units and people responsible for the financial management and control on the basis of the training strategy;
- Quality assessment and monitoring of functioning of Internal audit and financial management and control systems;
- To develop a plan for recruiting well qualified staff for the Centre and IAU-s and to increase staff salaries.
- The inadequately low number of internal auditors must be increased.

¹ <https://enablon.com/blog/2016/05/05/whats-the-difference-between-internal-audit-internal-control>

² <https://na.theiia.org/standards-guidance/Public%20Documents/IPPF-Standards-2017.pdf> pg.8

¹ International Standard on Auditing 240

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